Zimnat Asset Management

1st Quarter 2018 Investment Report

"In the business world, the rearview mirror is always clearer than the windshield" – Warren Buffett

Zimnat ASSET MANAGEMENT
associated with Sanlam group

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- Outlook is cloudy for the Chinese economy as two key growth engines - property and commodities - show signs of cooling.
- A surge in demand has put an end to the great commodity bear market that began in 2011.
- Sub-Sahara GDP is expected to grow by 3.4% driven by firmer commodity prices

Domestic Economy

- The World Bank estimates that in 2017, GDP growth was 2.8% and that this will decline to 0.9% in 2018.
- The 2017 Tobacco selling season has been deemed successful with sales clocking 190 million KGS generating US$ 600 million.
- Inflation going forward is going to be driven by the forex rate and the outlook for the sustainability of the USD status of the country.
- The fiscal deficit is projected by the government to decline to $ 671 million or 3.5% of GDP in 2018
- The proposed amendment of the Indigenization Law will maintain the 51/49 Indigenization threshold on diamonds and platinum sectors only, whilst opening other sectors of the economy to all investors.

Investment Market Outlook

- As at 23 March 2018 the bank weighted lending rates for individuals and corporate clients were 9.35% and 6.98% respectively
- With inflation gradually picking up and the absence of inflation indexed bonds, the bond market is becoming less attractive
- Weakness on the ZSE persisted throughout the beginning of Q1 as majority of the benchmark indexes closed in the red
- Market heavies drove aggregates as investors cherry picked the bourses blue chip counters

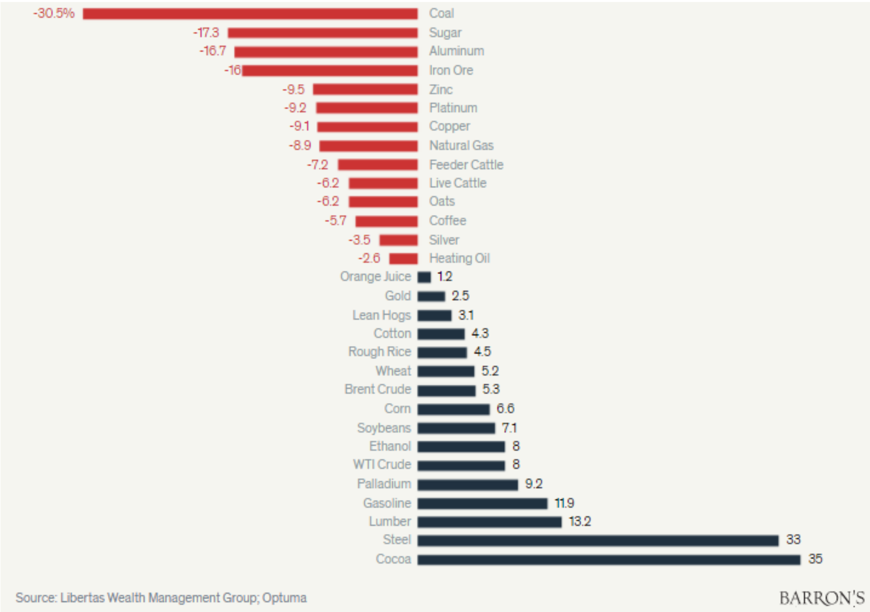
ZAM Strategy

- ZAM's strategy therefore remains focused on value preservation through consolidating our positions in defensive stocks
- ZAM has developed a pipeline of property development opportunities

2.0 GLOBAL ECONOMY

- **Global economy** - Data for Q1 signals that the global economy continues to sail smoothly, propelled by largely accommodative monetary policies, tight labor markets and robust global trade.
- Despite the solid economic backdrop, the threat of rising protectionism has dominated headlines in recent weeks. Notably, the United States announced on 22 March its first set of punitive actions against China by proposing tariffs on up to USD 60 billion of imports from the Asian giant. Although China showed readiness to retaliate by announcing tariffs on USD 3.0 billion of goods, the U.S. decision leaves room for negotiation before implementation, an opportunity Beijing is unlikely to ignore in a bid to prevent further escalation. The risk remains that if negotiations fail, U.S. protectionism will spiral out of control and cause an all-out trade war with China, which would harm both economies and throw a wrench in the works of the global economy.
- **US Economy**: Several Wall Street banks marked down their Q1 numbers. J.P. Morgan cut its forecast from 2.5% to 2%, while Goldman Sachs reduced its call from 2% to 1.8%t. All of the reductions, came after the disappointing 0.1% drop in retail sales and disappointing read in residential investment in mid-February. It's important to note that GDP growth for the first quarter has been historically slow for the US, with 2017 up just 1.2% and 2016 a scant 0.6% growth in GDP.
- **Europe:** The UK remained in a shallow downturn. In real terms, GDP is expected to expand by 1.5% in 2018.
- The brunt of the slowdown in the UK will continue to be borne by the household sector, with sluggish growth of retail sales and the housing market stuck in the doldrums. On a brighter note, however, the strengthening of overseas demand should continue to provide a fillip to the manufacturing sector and to exports.
- The Bank of England is expected to raise Bank Rate again in May
- , and then to go into 'wait and see' mode while the Brexit discussions and processes reach their end. A 'status quo' transition lasting for not more than two years is the most likely outcome, but will be of diminishing value to businesses the longer it takes to agree. Failure by the Cabinet to agree a common position would usher in a period of political instability and volatility in financial markets.
- **Chinese Economy:** China's economic activity remained strong in the 1st quarter, with hiring close to a record high, but the outlook is cloudy as two key growth engines - property and commodities - show signs of cooling.
- Weakness in the retail sector is of particular concern, with domestic demand hardly looking robust enough to support growth if China's exports suffer from punitive U.S. trade measures.
- The question is what's going to drive growth a year from now? Property and commodities both need an extended breather, and it's difficult to imagine the strong manufacturing performance of the last two years continuing much longer.
- **Sub-Saharan Africa**: GDP is expected to grow by 3.4% as firmer commodity prices drive many countries' mining and energy sectors, while large-scale infrastructure projects should improve the business environment and support activity. In addition, improved investor sentiment for the region's financials is supporting bonds and currencies, although it remains to be seen if it will hold up in the face of rising global interest rates. Issues including corruption, security problems, a lack of diversification and poor business climates will keep growth moderate overall. The willingness and ability of authorities to complete structural reforms and tackle bloated fiscal balances will be critical to the region's future growth prospects.
- **South Africa** escaped a third junk rating as Moody's Investors Service kept its assessment of the nation's debt unchanged, citing more transparent and predictable policies under President Cyril Ramaphosa.

- The African nation's outlook was revised to stable from negative. The decision will boost sentiment and probably bolster the rand, which rallied after Ramaphosa took over as leader of the ruling African National Congress in December 2017 and became president last month. With the local-currency rating remaining investment grade, the nation avoids being excluded from global benchmark indexes that could have led to outflows of as much as much as 100 billion rand (US$8.4 billion).
- Moody's maintained the nation's local- and foreign-currency assessments at Baa3, the lowest investment-grade level.
- **Commodities:** Commodities posted an overall gain in the first quarter. The surge in demand has put an end to the great commodity bear market that began in 2011.
- Concerns over a potential trade war, however, are prompting mixed reactions as traders weigh the potential impact of the Trump administration's import tariffs on steel and aluminum, and its plans to implement tariffs on Chinese goods. Steel demand was strong, running ahead of supply, and the three key consuming sectors of steel demand—construction, automotive and energy—are doing well.



- Gold and oil were among the commodity winners, but gains were modest. Inflation concerns, geopolitical tensions and interest-rate levels, especially real yields contributed to a rise in gold. Gold is likely to maintain at current levels.
- Natural gas took a hit from high U.S. production, and the lower price for natural gas in turn weighed on coal demand.

3.0 DOMESTIC ECONOMY

3.1 GROWTH FORECASTS

- **GDP growth** - The World Bank estimates that in 2017, GDP growth was 2.8% and that this will decline to 0.9% in 2018. These forecasts are more conservative than the government's view that output was forecasted to have grown by 3.7% in 2017 and will grow by 4.5% in 2018 premised by government charting a new way forward with economic and investment recovery measures mandated towards the "New Economic Order".
- **Agriculture** was estimated to have grown by 14.6% in 2017, on the back of above average rainfall, and government support for agriculture in the form of their command agriculture program. This saw the country recording record levels of maize production estimated at 2.2 million tonnes. Of this amount, 1.2 million tons of maize were sold through the Grain Marketing Board. The subsidized maize price offered by the GMB in 2017 was $ 390 per ton, against a grain miller selling price of $240 per ton. This subsidy is not likely to decrease in the coming season. The government is set to expand their command program to include wheat, soybeans, livestock, fisheries and irrigation rehabilitation. Government has pledged to allocate 9% of the total budget for 2018 to agriculture, an increase from 7% in 2017. Government expects the agricultural sector to grow by 10.7% and 8.1% for 2018 and 2019, respectively. Maize production in 2018 however, is expected to be lower than prior year given the lower than normal rainfall experienced from October to January [Except Mash East]; army worm infestation, and unavailability of top dressing fertilizer in some areas.

- **Wheat**: Projected winter wheat production in 2017 came to 160 000 tons, and is expected to increase to 200 000 tons in 2018. There has been a noticeable surge in private sector participation which has complemented the Command Agriculture scheme and thus government has targeted to produce 350 000 tons within the next three years to guarantee sufficient domestic supply and alleviate reliance on imports.
- **Tobacco:** the 2017 selling season has been deemed successful with sales clocking 190 million KGS generating US$ 600 million. Production for the current year is forecast by government at 200 million KGS. The government has reviewed upwards the tobacco export incentive from 5% to 12% for the coming season with cash payouts to farmers likely to decline substantially. The impact of the erratic rainfall pattern on tobacco production is yet to be fully assessed.
- **Mining:** The mining sector in Zimbabwe is set to grow by 6.1% in 2018 after growing by an estimated 8.5% in 2017 according to the government. The growth in 2018 is expected to be driven by increases in gold, coal and diamond production and increases in platinum, nickel, and chrome prices.

3.2 ECONOMIC ACTIVITY

- **Money supply:** Broad money supply grew by 44% from $5.6 billion in December 2016 to $8.1 billion in December 2017. Physical cash remains rare and there is no indication that this will change. This plastic money drive is costing consumers as banks are charging high fees on transactions resulting in most banks making extraordinary profits from non-funded income.
- **Inflation outlook**: Developments have reversed from previous experiences of deflation to onset of rising prices. Month on month inflation began to rise from September 2017 registering at 0.4%, then increasing to 1.5% in October and then reducing to 0.7% and 0.53% in November and December respectively. Annual inflation as at December was at 3.46% and whilst much higher than the prevailing average was widely believed to understate the increases in prices which has been taking place since the onset of foreign currency shortages. The rate at which forex is exchanged in the black market has been very volatile. After remaining at ~30% for some time, the rate rose sharply to 90% just before the events of "operation restore legacy" in November 2017. The rate has since fallen around 45% as at April 2018. Inflation going forward is going to be driven by the forex rate and the outlook for the sustainability of the USD status of the country.
- **Balance of Payments:** Total exports for the first 11 months of 2017 are expected to have grown by 40% to $3.5 billion, because of strong performances in tobacco, PGMs and gold, while imports were expected to have been $4.9 billion resulting in an expected trade deficit of $ 1.4 billion for the first 11 months of 2017. This was despite a large decline in food imports. To add to this BOP challenge, many individuals and companies have attempted to externalize their earnings.
- **Government:** The government continues to live well beyond its means. They continue to finance this through Treasury Bill/Bond issuances and an RBZ overdraft. The fiscal deficit estimated for 2017 is $ 1.7 billion or 9.4% of GDP. It is projected by the government to decline to $ 671 million or 3.5% of GDP in 2018, although this is unlikely given their commitment to their workforce and to agricultural subsidies and support. This overspending has led to total government domestic debt growing to by 70% in 2017 to $6 billion translating to a total government debt position of $13.5 billion, after factoring in government foreign debt. This growth in domestic government debt is what is driving money supply growth and is contributing to inflation meaningfully.
- **Foreign Direct Investment:** The proposed amendment of the Indigenization Law through the Finance Bill with effect from April 2018 will maintain the 51/49 Indigenization threshold on diamonds and platinum sectors only, whilst opening other sectors of the economy to any investor regardless of nationality, will in our opinion, translate to a gradual increase in foreign direct investment which is crucial for long-term sustainable growth in Zimbabwe.

- The zero tolerance approach to corruption by the new President, will surely reduce leakages from the fiscus, boost investor confidence and tourist arrivals. Reducing corruption also reduces the cost of doing business in Zimbabwe, thereby restoring the country's competitiveness as a credible investment destination on the global stage.
- Furthermore, the new government's commitment to strengthen its re-engagement with the international community and honoring its bilateral obligations is likely to result in increased international budgetary support.

3.3 ECONOMIC OUTLOOK

- With the major shift in political environment, the general sentiment is that the country will become more open to global investors and production is expected to gradually improve over time. The death of respected long time opposition leader Morgan Tsvangirai has brought in a new leadership to the opposition. Elections, due to be held between July and August of this year, are being watched closely and will have a significant impact on the outlook for the country. Despite apparent gains from the change in dispensation, the fundamental problems in the economy including the enormous budget deficit, rising prices, uncertainty regarding the sustainability of the multicurrency regime are still a reality and need to be resolved before meaningful gains can be made.
- Overall, we are adopting a cautiously optimistic approach and we caution investors and stakeholders to have realistic expectations with regards to the new Government, as they have to claw out of decades of economic meltdown, a culture of corruption, and isolationism.

4.0 INVESTMENT MARKETS

4.1 Money Market Investments

- As at 23 March 2018 the bank weighted lending rates for individuals and corporate clients were 9.35% and 6.98% respectively.
- Average savings deposit rates rose to 3.97% p.a. in the sector although a material change in the rates is not expected in the immediate future given the growth in liquidity across the banking sector.

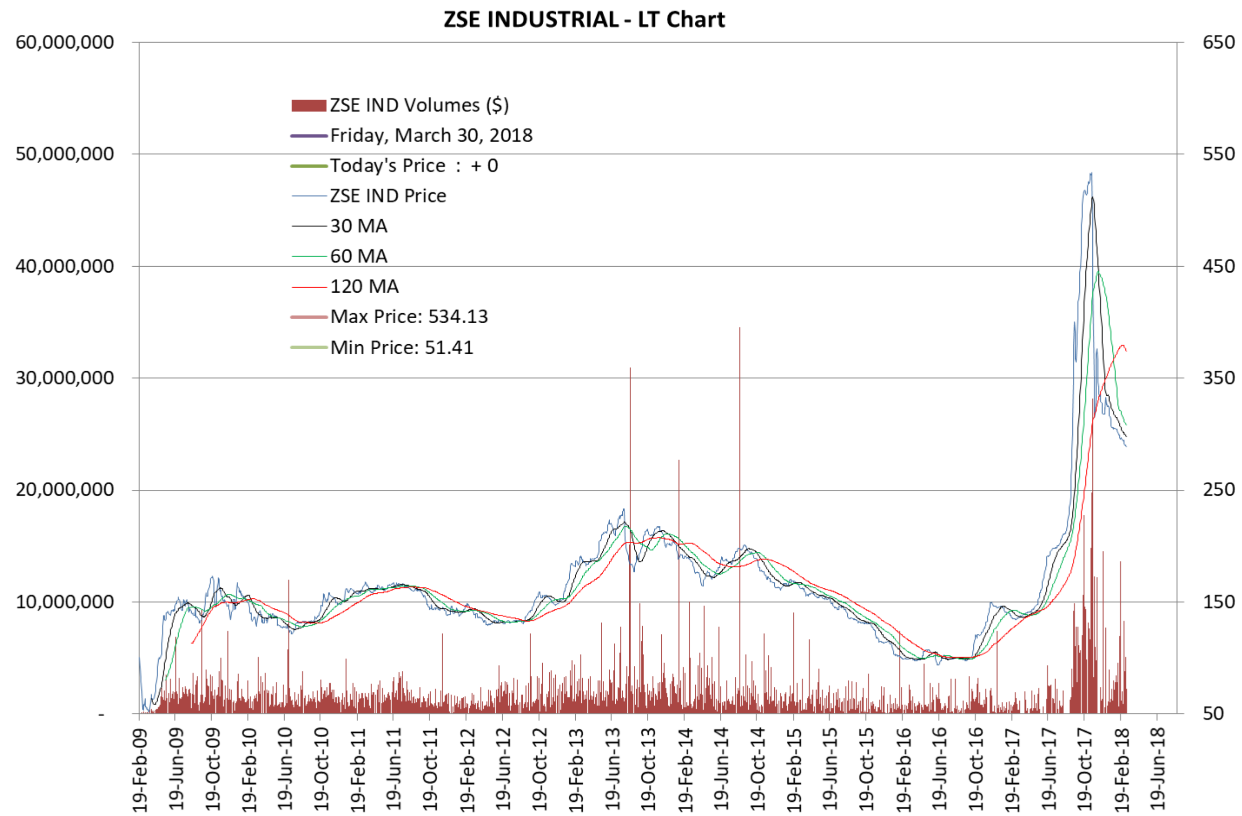
4.2 The Bond Market

- The continued depressed rates on money market instruments should in theory make yields on the bond market attractive to investors looking for options in the fixed income market. However with inflation gradually picking up and there being a lack of inflation indexed bonds, the bond market becomes less attractive. Bond yields have continued to range between 5% and 8%p.a.

4.3 Equities

- **Stock Market Performance**: Weakness on the ZSE persisted throughout the beginning of Q1 as majority of the benchmark indexes closed in the red amidst softening prices in the market heavies on selling pressure. Even despite a spate of improved financial performances in the ongoing reporting season, gains were hardly felt as the market continued on its path to self-correction.
- Towards the end of March, the ZSE sustained gains in major indices on the back of a combination of firming demand and scarcity of sellers.
- All four ZSE market indices capped the quarter in the red with the All Share Index down 13.02%, Industrial Index shedding 12.62%, Mining Index declining 12.2% and the Top Ten Index falling 14.29%.
- **Earnings**: Market heavies drove aggregates as investors cherry picked the bourses blue counters. Volumes, while tame over the first quarter ended with a turnover at 16.62 million shares spurred by top volumes in FMP, Turnall and Econet which accounted for a combined 45% of the aggregate.

- **TSL**: performance in Q1 was better than prior year lifted by strong performances in its agricultural operations on the back of product availability and satisfactory weather patterns. This season's national crop is estimated to around 200 million kgs against 189 million kgs last year.
- **Old Mutual Zimbabwe**: Profit after tax was up 139% from US$91.8 million to US$219.3 million driven largely by a strong operating profit across the business as well as non-banking investment returns which grew by 448% from US$116.9 million to US$640.9 million. The growth in investments was mostly due to the Group's exposure in listed equities as the ZSE recorded significant gains with the Industrial Index and mining indices closing 2017 with full year gains of 130.42% and 143.38% respectively.
- **RIOZIM**: the group saw a 31% growth in gold production to 2.1 tons from 1.6 tons produced in 2016 while similarly Murowa Diamond's attained 69% growth in production compared the 2016. Plans to increase a significant step change in performance were stalled by incessant rains experienced in Q1 2017. Furthermore, performance was overshadowed by the fact that RioZim received no more than 14% of its gold export proceeds in foreign currency and the remainder in RTGS credits causing the group substantial losses. Revenue performance did grow by 36% on the back of increased average gold prices of US$1255/oz compared to US$1251/oz achieved in 2016. This growth was achieved despite the fact that Empress Nickel Refinery remained under care and maintenance.



- **Outlook**: overall the operating environment remains tough, with challenges continuing to stem from shrinking disposable incomes as prices continue to rise, increased difficulties in importing goods due to lack of foreign currency as well as a general lack of competitiveness of companies when compared to regional peers.

- While the change in government has been largely seen as a positive, investors continue to adopt a “wait and see” approach until after elections about whether the necessary reforms will be made and the ensuing impact on the economy. Stock market valuations remain elevated, but have been normalizing with the better than expected financial performances across the bulk of the market.
- Given the record low interest rates, rising inflation, and local currency uncertainty, we believe that investors will revert back to the stock market – and some have already begun to – despite the relatively elevated valuations in search of above inflation returns.

5.0 STRATEGY

5.1 Equities

- The biggest risks we are seeing are in the monetary sector of the economy, namely, the record low interest rates, the high inflation expectations, and the uncertainities around the introduction of a new local currency post elections. We strongly believe that the above three key market risks provide a compeling investment case for equities.
- Whilst the market remains relatively expensive from a valuation perspective, the strong financial performances across most companies that released their results at the end of December 2017, have started normalising the valuations and in some cases some companies have become cheap. We also believe that the strong financial results are also a sign of inflation in its initial phases, which we expect to transition into the broader economy through wage increases, bonuses, dividends, and overall demand aross the entire economy.
- Our strategy therefore remains focused on value preservation through consolidating our positions in defensive stocks. In selecting our equity holding we will continue prioritising companies with a strong cash flow generating capacity, robust and resilient business models, and a solid governance trackrecord and structures.

5.2 Fixed Income

- The fixed income market remain the least attractive given the monetary risks within the economy. Against this background, we plan on minimising exposure to this asset class, until there is clarity as to where the country is going on the monetary front.

5.3 Alternative Investments

- We have developed a pipeline of property development opportunites valued at around $30 million, all of which are at various stages of implementation. We therefore will continue to approach clients on an individual basis when such projects are ready for investment.

5.4 Asset Allocation

- Given the uncertainties on the monetary front, our overall asset allocations will be biased towards equities. As and when our property development opportunities become available for investment, we therefore will switch clients interested on each project out of equities and into the development property.

6.0 PERFORMANCE RANKINGS

Performance Survey as at 31 December 2017 for Discretionary Balanced Portfolios

ASSET MANAGER	Invesci	Imara	Zimnat	Smartvest	Datvest	Platinum	OMIG	ABC	Atria	Alpha	Purpose	ZSE Industrial Index
Q1 2017	-2.04%	-2.54%	1.61%	-0.73%	-0.25%	2.20%	-2.20%	1.36%	2.59%	1.81%	0.81%	-3.85%
Position Q1	9	11	4	8	7	2	10	5	1	3	6	
Q2 2017	34.49%	28.13%	22.79%	20.37%	29.75%	22.02%	26.34%	18.40%	17.80%	10.31%	5.70%	41.03%
Position Q2	1	3	5	7	2	6	4	8	9	10	11	
Q3 2017	102.02%	84.02%	55.74%	78.46%	88.90%	66.45%	74.49%	59.83%	67.08%	33.26%	40.88%	113.50%
Position Q3	1	3	9	4	2	7	5	8	6	11	10	
Q4 2017	-28.30%	-18.27%	-5.05%	-15.16%	-26.16%	-14.03%	-19.05%	-16.06%	-22.34%	-8.06%	-33.24%	-20.40%
Position Q4	10	6	1	4	9	3	7	5	8	2	11	
Full year 2017	90.83%	87.81%	84.57%	80.92%	80.53%	78.45%	74.53%	61.01%	56.81%	37.60%	-6.72%	130.42%
Year 2017 Position	1	2	3	4	5	6	7	8	9	10	11	
Closing Value as at 31 Dec 2017 US$ Millions	$57.45M	$231.21M	$47.29M	$6.85M	$156.46M	$4.71M	$206.22M	$115.91M	$5.25M	$9.8M	$2.3M	

Asset Manager Cumulative Returns

ASSET MANAGER	Zimnat	Imara	Platinum	Datvest	Smartvest	OMIG	ABC	Alpha	ZSE Industrial Index
3 Year Rolling Return	115.41%	105.07%	99.80%	95.79%	94.79%	85.89%	79.31%	70.24%	104.57%
Position	1	2	3	4	5	6	7	8	

ASSET MANAGER	Zimnat	Alpha	Platinum	Datvest	Imara	Smartvest	OMIG	ABC	ZSE Industrial Index
4 Year Rolling Return	124.13%	90.77%	90.21%	88.30%	81.58%	79.80%	78.06%	66.96%	64.44%
Position	1	2	3	4	5	6	7	8	

ASSET MANAGER	Zimnat	Imara	Platinum	Datvest	Smartvest	Alpha	OMIG	ABC	ZSE Industrial Index
5 Year Rolling Return	173.01%	137.92%	124.56%	121.05%	116.27%	115.97%	112.14%	104.32%	118.17%
Position	1	2	3	4	5	6	7	8	

Asset Manager Yearly returns 2013-2017

ASSET MANAGER	Imara	Zimnat	Smartvest	Datvest	Platinum	OMIG	ABC	Alpha	ZSE Industrial Index
FY 2017	87.81%	84.57%	80.92%	80.53%	78.45%	74.53%	61.01%	37.60%	130.42%
Position	1	2	3	4	5	6	7	8	
FY 2016	21.15%	19.61%	29.38%	19.39%	25.98%	15.75%	22.28%	16.54%	25.83%
Position	4	5	1	6	2	8	3	7	
FY 2015	-9.54%	-1.89%	-16.78%	-9.16%	-11.12%	-7.98%	-8.84%	6.17%	-29.45%
Position	6	2	8	5	7	3	4	1	
FY 2014	-11.46%	4.05%	-7.70%	-3.92%	-4.80%	-4.26%	-6.88%	11.52%	-19.46%
Position	8	2	7	3	5	4	6	1	
FY 2013	31.03%	21.81%	20.28%	17.39%	18.06%	19.14%	25.54%	13.21%	32.62%
Position	1	3	4	7	6	5	2	8	

Source: MINERVA

7.0 INTERNATIONAL CURRENCY AND STOCK MARKET PERFORMANCES

International Stock Market Performance -2018										
		LOCAL EXCHANGE RATE TO USD			INDEX IN LOCAL CURRENCY			US DOLLAR CONVERTED		
	Index	31-Dec-17	31-Mar-18	YTD Change	31-Dec-17	31-Mar-18	YTD Change	31-Dec-17	31-Mar-18	YTD Change
Advanced Economies										
United States	Dow Jones Industrial	1.00	1.00	0.0%	24,719	24,103	-2.5%	24,719	24,103	-2.5%
Britain	FTSE 100	0.74	0.71	-3.9%	7,688	7,057	-8.2%	10,372	9,904	-4.5%
Japan	NIKKEI 225	112.66	106.24	-5.7%	22,765	21,159	-7.1%	202	199	-1.4%
Emerging Economies										
Brazil	Bovespa Index	3.31	3.03	-8.4%	76,402	84,360	10.4%	23,065	27,812	20.6%
Russia	MICEX Index	57.64	57.26	-0.7%	2,110	2,286	8.3%	37	40	9.0%
India	S&P BSE SENSEX Index	63.78	64.98	1.9%	34,057	32,969	-3.2%	534	507	-5.0%
China	Shanghai SE Composite	6.51	6.28	-3.6%	3,307	3,161	-4.4%	508	503	-0.9%
South Africa	JSE ALSI	12.37	11.83	-4.4%	59,505	55,475	-6.8%	4,811	4,691	-2.5%
Sub-Sahara Countries										
Zimbabwe	All Share Index	1.00	1.00	0.0%	100	87	-13.0%	333	87	-73.9%
Zambia	LUSE All Share	10.01	9.51	-5.0%	5,328	5,548	4.1%	532	584	9.7%
Botswana	DCI Index	9.85	9.55	-3.1%	8,860	8,590	-3.1%	899	899	0.0%
Tanzania	All Share	2,239	2,257	0.8%	2,396	2,409	0.5%	1.07	1.07	-0.3%
Nigeria	Nigeria All Share	359.78	359.95	0.0%	38,243	41,505	8.5%	106	115	8.5%
Ghana	GSE Composite	4.53	4.42	-2.4%	2,580	3,367	30.5%	569	761	33.7%
Kenya	NSE 20	103.22	100.84	-2.3%	3,712	3,845	3.6%	36	38	6.0%
Mauritius	SEMDEX	33.70	33.53	-0.5%	2,202	2,288	3.9%	65	68	4.4%

ZSE INDUSTRIAL INDEX - TOP 5 COUNTERS BY MARKET CAPITALIZATION						
Name	Sector	Price US cents 31 March 2018	Weight- 31 March 2018	Market Cap US$ 31 December 2017	Market Cap US$ 31 March 2018	YTD Change in Market Cap
Delta Corporation Limited	Beverage	1.59	24.93%	2,011,858,725	1,996,141,079	-0.78%
Econet Wireless Zim	Technology	0.67	13.36%	1,516,988,724	1,069,876,258	-29.47%
Innscor	Industrial Holding	0.97	6.56%	541,593,440	525,345,637	-3.00%
Seedco	Agricultural	1.95	5.86%	481,478,480	469,441,518	-2.50%
British American Tobacco	Agriculture	20.00	5.15%	742,806,612	412,670,340	-44.44%
Sub-Total			55.88%	5,294,725,981	4,473,474,831	-15.51%
ZSE Industrial Market Capitalization				**9,296,489,814**	**8,202,946,379**	**-11.76%**